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California Legislature



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December 16, 1977

Letter Report 306.2

Honorable Bill Greene
Room 4072, State Capitol
Sacramento, California 95814

Dear Senator Greene:

Your Joint Legislative Audit Committee respectfully forwards the Auditor General's letter report on the Department of Rehabilitation's Business Enterprise Program.

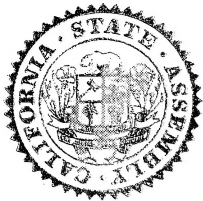
By copy of this letter, the Department is requested to advise the Joint Legislative Audit Committee within sixty days of the status of implementation of the recommendations of the Auditor General that are within the statutory authority of the Department.

The auditors are Kurt R. Sjoberg, Audit Manager, and John Sontra.

Cordially,

MIKE CULLEN
Chairman

cc: Speaker of the Assembly
President pro Tempore of the Senate
Members of the Joint Legislative
Audit Committee



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December 12, 1977

Letter Report 306.2

Honorable Mike Cullen
Chairman, and Members of the
Joint Legislative Audit Committee
Room 5144, State Capitol
Sacramento, California 95814

Dear Mr. Chairman and Members:

In response to a resolution of the Joint Legislative Audit Committee, we are examining the Department of Rehabilitation's Business Enterprise Program (BEP). This examination is being conducted under the authority vested in the Auditor General by Section 10527 of the Government Code.

This report answers the Legislature's specific questions on the purchase of equipment for BEP and discusses weaknesses in program management. We issued a report on BEP's fee schedules in July 1977,* and another report examining the program's financial statements and making an auditor's opinion thereon will be forthcoming.

We found that a physical inventory of BEP equipment conducted by the Department and a private firm revealed that the equipment records were understated by \$1.2 million. In addition, numerous recommendations made by the Department of Finance in a 1975 audit of program operations have not been implemented, and excessive costs have been incurred in constructing of new facilities.

* Letter report 306.1, "Impact of Alternative Fee Schedules," July 18, 1977.

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Background

The Business Enterprise Program is authorized under the federal Randolph-Sheppard Act of 1936 and California legislation enacted in 1945. The Act authorizes the program to operate facilities on federal property, while California legislation authorizes the program to operate facilities on state, county and city property. BEP is organized under the Department of Rehabilitation's Program Support Division and operates from a central office in Sacramento and four area offices in Los Angeles, San Diego, San Francisco and Sacramento. BEP's staff of 38 people supervises blind individuals at approximately 320 vending and food service facilities throughout California. Since 1947, the program has expanded from the operation of small tobacco stands located in government buildings to 24-hour cafeterias located in privately owned buildings.

The California Welfare and Institutions Code states that BEP was established "For the purpose of providing blind persons with remunerative employment, enlarging the economic opportunities of the blind, and stimulating the blind to greater efforts in striving to make themselves self-supporting...." To accomplish these ends, BEP constructs and supervises vending stand and food service facilities and acts as the licensing agency which authorizes the legally blind to operate on government locations and in private industry. BEP also collects fees from blind operators to support vending stand operations. These fees, which are referred to as set-aside funds, are deposited in the Special Deposit Fund. Expenditures from the fund are eligible for federal matching funds. Equipment purchases represent approximately 32 percent of the fund's annual expenditures.

Equipment Purchases

The request for the audit specifically asked that the Auditor General answer these questions:

- What equipment did the Department purchase?
- When was the equipment purchased?
- From whom was the equipment purchased?

To answer these questions, we reviewed and tested BEP procurement and accounting procedures. We found a number of problems with the Department's management of equipment inventories. However, in the

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Chairman, and Members of the
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course of our audit, the Department's internal auditor issued a final report* identifying similar problems with BEP equipment records and procurement procedures. The report contained a number of specific recommendations.

Subsequently, the Department contracted with a private firm to conduct a statewide physical inventory of all BEP vending equipment to correct the accounting records. The Department and the independent firm conducted the physical inventory from March 24, 1977 to April 8, 1977.

After completion of the physical inventory, the Department issued a report indicating the discrepancies between the old inventory records and the initial physical inventory results. The physical inventory identified 3,822 equipment items, totaling \$2,132,278, which were not listed on the old records. Also, 3,460 equipment items, totaling \$1,751,127 which were listed on the old records were not found. The results, as later adjusted by the Department, show that the BEP had \$6.2 million in equipment as of April 8, 1977, approximately \$1.2 million more than was shown on the Department's records.

The Department implemented new procedures aimed at maintaining the accuracy of the equipment records after the physical inventory was completed.

The questions raised by the Legislature are answered as follows.

What Equipment Was Purchased?

Based upon our observation of the statewide physical inventory ending April 8, 1977, and upon our review of equipment transactions over the preceding 21 months, the following list represents equipment typically purchased:

- Adding Machine
- Air Conditioner
- Air Cooler, Evaporative
- Alarm and Signal Systems
- Broiler, Electric
- Broiler, Gas
- Building, Prefabricated Sectional
- Cabinet, Display
- Cabinet, Metal Storage

* Department of Rehabilitation, Report on Business Enterprise Program Equipment Review, dated January 20, 1977.

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Cabinet, Wood Storage
Calculator, Electronic Single Line Display
Cart, Food
Cart, General Hauling
Chopper, Electric Food
Coffee Brewer, Commercial
Coin Sorter
Compactor, Rubbish
Compressor, Refrigeration
Convertor, Live Roller or Belt Type
Cooler, Drinking Water
Counter, Metal
Counter, Wood
Desk, Metal Not Otherwise Listed
Desk, Wood Not Otherwise Listed
Dishwashing Equipment, Institutional
Dispenser, Refrigerated Milk
Dispenser, Refrigerated Beverage
Doughnut Machine, Cutting and Frying
Door, Air (Insect Screen Blower)
Drinking Fountain, Refrigerated
Floor Machine Not Otherwise Listed
Food Warmer, Other
Food Warmer, Drawer Unit
Freezer, Chest
Freezer, Merchandiser
Freezer, Upright
Fryer, Electric
Fryer, Gas
Garbage Disposal Machine, Commercial
Gate, Security Turnstiles
Griddle, Electric
Griddle, Gas
Grinder, Electric Food
Heater, Electric Water
Heater, Gas Water
Ice Maker, Counter
Ice Maker, Floor
Inter Comm. and P.A. Systems
Laundry Equipment Not Otherwise Listed
Lowerators, Portable
Meat Tenderizer, Electric
Mixer, Food Electric Commercial
Oven, Electric
Oven, Gas
Oven, Infrared

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Oven, Radar
Partitions, Portable or Knockdown
Peeler, Abrasive Electrical
Planter, Wood and Ornamental
Pump, Rotary Power Driven
Range, Electric
Range, Gas
Refrigerator, Commercial Solid Door, 1 to 4 Door
Refrigerator, Display Commercial Sliding Door, 1 to 3 Door
Refrigerator, Dual Temperature Commercial, 1 to 2 Section
Refrigerator, Household
Refrigerator, Sandwich Unit 3' to 8'
Register, Cash
Safe and Vault
Scale, Floor
Shelving Units, Stainless Steel
Sink, Stainless Steel
Slicer, Food Electric Commercial
Stand, Metal Heavy Duty
Steam Cleaning Unit
Steamer, Food
Steam Kettle, Gas or Electric
Table, Metal Utility
Toaster, Commercial
Trailer House and Office
Typewriters, Not Otherwise Listed
Vacuum Cleaning Equipment, Other
Vending and Coin Operated Machines
Ventilation, Fire Suppression System
Ventilation, Cooking Hood System

When Was the Equipment Purchased?

According to the Department's records as of June 30, 1977, equipment has been acquired as shown below:

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<u>Age</u>	<u>Number of Items</u>	<u>Original or Estimated Cost</u>
10 years old	4,074	\$2,197,587.11
9 years old	398	257,735.17
8 years old	569	448,014.34
7 years old	392	283,665.77
6 years old	550	423,695.17
5 years old	925	650,594.57
4 years old	499	386,932.29
3 years old	306	196,724.28
2 years old	623	476,416.84
1 years old	369	239,430.49
less than one year	<u>1,034</u>	<u>768,276.83</u>
Total	<u>9,739</u>	<u>\$6,329,072.86</u>

From Whom Was the Equipment Purchased?

Our review of equipment acquisition was limited to a sample of transactions over a 21-month period ending March 31, 1977. Approximately 77 percent of the equipment was purchased prior to our test period. The following is a list of vendors who were identified in our review as having sold equipment required to be inventoried. Therefore, this list does not include all vendors who have sold equipment to the Department over the 21-month period.

Everfrost, Inc.
Gold Desk and Safe Co. Inc.
K. M. Ledbetter Cabinet Top
H. Argondizza
C. R. Reichel Engineering Co. Inc.
Golden West Equipment Inc.
Angelos Plumbing Co.
Kellum Sound Co.
Barr Manufacturing Co.
Sears
Ralphs Distributing Co. Inc.
Glasser Bros.
Rodoc Enterprises
Dr. Pepper Bottling Co.
K & S Supply Co.

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Thoma's Sheet Metal
Finegold's
Food Facilities Equipment
Keoshian Co.
Pelco Dist.
Cederquest
Mobil Lease Co.

To purchase equipment exceeding \$200 in cost, the Department submits a purchase estimate to the Office of Procurement within the Department of General Services. The Office of Procurement's buyers notify all vendors from a list of approved vendors. After obtaining the bids, the buyer selects the lowest responsible bid and issues a purchase order to the appropriate vendor. A copy of the purchase order is forwarded to the Department. The Department receives the equipment and authorizes the payment of the vendor's invoice.

In emergency circumstances, the Office of Procurement may authorize the Department to purchase equipment directly from a vendor. These circumstances may arise if a refrigerator or other equipment item breaks down and a blind operator is in danger of losing considerable inventory. The Department may also seek such authorization in order to meet agreements with outside parties to open facilities by a particular date. When authorizing the Department to purchase directly, the Office of Procurement prepares and forwards a Form 42 "Authorization to Exceed Monetary Limits of SAM 3571.1 by Sub-Purchase Order."

Failure to Implement Earlier Audit Recommendations

In a 1975 audit of the BEP, the Department of Finance* made a number of recommendations to improve program management. In their response to the report, the Department of Rehabilitation agreed with most of the recommendations and suggested that corrective action would be taken.

We found that while some corrective action has been initiated, the following problems identified by the Department of Finance remain uncorrected:

- No comprehensive policies or procedural manual have been prepared
- Meaningful objectives for the program have not been established

* Department of Finance, Report No. PR-129, Business Enterprise Program, December 1975.

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- Little management information is available concerning any aspect of the program
- No departmental plan exists for expending set-aside funds
- Cost budgets for the vending facilities have not been developed to manage expenditures from the set-aside funds. No assurances exist that the expenditures made are the most economical
- Efforts to follow up on delinquent service charges and loan payments by BEP personnel are inconsistent
- Operators are not billed for outstanding loans
- Penalties are not applied to late payments of service charges or loans.

The impact of these problems is demonstrated by inconsistent management policies and budgets prepared without detailed plans or specific objectives.

For example, policy commitments regarding the allocation of federal funds and salaries of BEP personnel as applied to the set-aside accounts have not been firmly established. We found that:

- A recent departmental decision would have eliminated \$489,671 or 49 percent of the federal reimbursement funds which were to be transferred to the set-aside accounts despite expenditure commitments already incurred. The decision was temporarily reversed but the basis for allocating federal funds in the future has not been settled.
- Because of a shortage of state funds in 1974, the Department began charging the set-aside accounts for the salaries and related costs of various BEP personnel. The practice was discontinued after two years, and a portion of the charges were reimbursed to the set-aside accounts.

Coordination Needed for Opening New Facilities

Currently, about 20 percent of the program's effort is aimed at opening 20 new facilities per year. Over the preceding four years, the Department has opened an average of 15 new facilities per year. We found, however, that ineffective coordination exists among BEP personnel in the construction of new facilities.

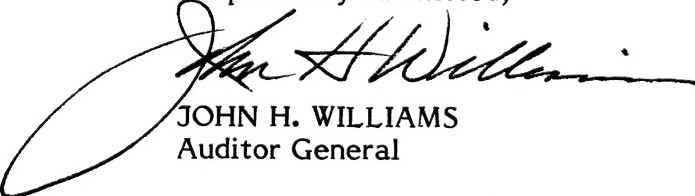
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For example, we reviewed 17 construction files with BEP personnel and found that an estimated \$80,000 of unnecessary construction costs had been incurred. BEP personnel conceded that these costs result because responsibilities for various functions, including promotion, design and supervision, are not clearly delineated among BEP personnel.

Conclusions and Recommendations

Management problems currently exist which would have been improved if the Department of Finance's 1975 audit recommendations had been implemented. We recommend that the Department continue to develop plans to implement the recommendations suggested by the Department of Finance. In addition, the Department should delineate responsibilities for promotion, design and supervision of new vending facilities to be constructed.

Respectfully submitted,



JOHN H. WILLIAMS
Auditor General

Attachment: Agency Response

Staff: Kurt R. Sjoberg, Audit Manager
John P. Sontra

Memorandum

To : John H. Williams
Auditor General
Joint Legislative Audit Committee
925 L Street, Suite 750
Sacramento, California 95814

Date : December 12, 1977

File No.:

Telephone: ATSS (916) 445-3971
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From : **Department of Rehabilitation**
OFFICE OF THE DIRECTOR

Subject: Letter Report 306.2

We have reviewed the draft of Letter Report 306.2 concerning your review of the purchase of equipment and program management in the Business Enterprise Program (BEP). We are in general agreement with the contents of the Letter Report in regard to inventory, the recommendations of the Department of Finance Report, and coordination for construction of facilities. We, however, would like to add some additional information regarding each of the issues.

The physical inventory of equipment was a team effort involving staff from both a private inventory firm and BEP staff. At the same time as the physical inventory was done, we converted from our old equipment record system to a new one. A property clerk has been added to the BEP central office staff to maintain the equipment records and serve as a resource to other BEP staff on the equipment record procedures. Of the equipment on the old records that was not found during the physical inventory, 82% of it was five years old or older and 42% was ten years old or older. It is our opinion that many of these items were listed as found items because their identification tags from the old system were missing and we were unable to match these items up with the old records. To deal with this problem, the new system included metal tags that are riveted to the equipment. Also, the old system was cumbersome and led to documents being filed incorrectly or lost, causing discrepancies between the local records and the central file. We believe our new system will minimize this type of problem.

As indicated in the Letter Report, we agreed with most of the recommendations in the report by the Department of Finance. We, in fact, have viewed it as a blueprint for action in BEP. Many of the major recommendations have already been implemented including:

1. The integration of blind vendor training into the BEP organizational structure.
2. Pretraining screening for potential trainees.
3. Better use of trainee on-the-job training.
4. Inclusion of input from BEP staff and vendors into the vendor training program.

5. The establishing of the California Vendors Policy Committee to participate with the Department in administrative decisions regarding BEP.
6. A study of the BEP personnel structure which has led to a classification change proposal that is currently being reviewed by State Personnel Board staff.
7. Recruiting for qualified blind individuals for BEP line positions which has led to the hiring of the first blind Business Enterprise Officer in the history of the program.
8. Contracting with the Department of General Services for review of all vending machine operations on state property.

In addition, we worked closely with the blind vendors and organizations of the blind for the passage of major legislation (SB 468) regarding the program. We will be drafting new BEP rules and regulations to conform with the new legislation.

The Department is currently working on, or has specific plans to deal with, each of the recommendations from the Department of Finance Report listed in the Letter Report. The Auditor General is aware of this, but did not include it in the Letter Report, therefore, the picture is not complete. Action on some recommendations was held up pending the passage of SB 468. The changes necessary to deal with some of the problem areas, such as penalties for late payments, will be dealt with in the new BEP regulations. A major step in responding to the Department of Finance recommendations will be the implementation in January of the automated BEP management information system which has been several months in the planning. This will not only provide us with regular meaningful and useful data, but will facilitate our work on several of the other problem areas. In particular it will provide us the data to realistically budget set-aside funds and develop cost budgets for the vending facilities.

It should be noted that although the Department of Finance Report is dated December 1975, it was not released until July 1976. Therefore, we have had just over a year to move on the identified problem areas. As indicated, we have taken action on a number of the problem areas noted. We will continue to work on the remaining areas as planned. Eventually we will implement most of the recommendations from the Department of Finance Report. In some instances policy issues are involved where we have differences of opinion with the Department of Finance involving interpretation of the enabling legislation.

Coordination for opening new facilities as well as remodeling of existing facilities has been a problem in the past. As indicated in the Letter Report, part of the problem has been the lack of coordination among BEP personnel. Another has been inadequate staffing to keep up with the volume of work. This has indeed led to unnecessary construction costs on some occasions. This, however, is not a problem unique to BEP. In the past months, we have taken several positive steps to correct this problem. New staff positions have been

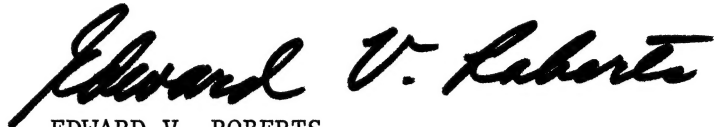
Mr. Williams

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added to do the job. A new BEP organizational structure was recently approved and a new BEP central office administrative position is being added. A major assignment for the person selected for this position will be statewide central coordination of the promotion of new locations. We are already in the process of instituting new internal operating procedures defining the role and involvement of the various BEP staff members in construction and remodeling activities and the proper sequence of activities.

We appreciate the opportunity to review and respond to the draft of Letter Report 306.2. We are looking forward to seeing the results of the fiscal audit.

A handwritten signature in black ink, reading "Edward V. Roberts". The signature is written in a cursive, flowing style with a large initial "E".

EDWARD V. ROBERTS
Director